ALLIANZ OF AMERICA CORPORATION
MUNICH REINSURANCE AMERICA CORPORATION
SWISS RE AMERICA HOLDING CORPORATION

These comments are submitted by Allianz of America,[1] Munich Reinsurance America,[2] and Swiss Re America.[3] For the past three years, the Administration's Budget has included a proposal to deny the deduction for property-casualty reinsurance premiums placed with a foreign affiliate by a U.S. insurer.[4] The Administration proposal was introduced in the 112th Congress by Rep. Richard Neal (H.R. 3157) and by Sen. Robert Menendez (S. 1693).

These comments demonstrate that the Administration proposal would disrupt essential risk distribution practices followed by domestic and foreign insurers, alike; increase premiums and reduce coverage available to U.S. consumers, particularly in catastrophe prone areas along the coastlines; and violate U.S tax treaty obligations and commitments to the World Trade Organization. In addition, the Administration errs in characterizing routine affiliate transactions with treaty partners with significant corporate tax regimes as erosion of the U.S. tax base.

BACKGROUND

Under current law, a U.S. insurer may deduct the premium for reinsurance placed with another company, whether affiliated, unaffiliated, domestic or foreign. A current deduction for this crucial expense ensures that there is a proper matching of income and expense. The U.S. insurer will include in income any ceding commission received from the reinsurer, and, when it

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[1] Allianz S.E., a German company, owns Fireman's Fund Insurance Company, Allianz Global Corporate and Specialty Insurance, Euler Hermes-USA, and Allianz Global Assistance –USA. Together, Allianz's property-casualty insurance subsidiaries in the U.S. employ approximately 5,100 people. Allianz is one of the world's largest financial services companies.

[2] In the U.S., Munich Re provides access to a full range of property and casualty reinsurance and specialty insurance products through Munich Reinsurance America, Inc., American Modern Insurance Group and Hartford Steam Boiler Group. The combined property/casualty companies employ about 3,550 people in the U.S. The German parent, Munich Reinsurance A.G., is the world's largest reinsurer.

[3] Swiss Re, the world's second largest reinsurer, has been based in Zurich, Switzerland since 1863. The company operates in the U.S. through two primary carriers, Swiss Reinsurance America and Swiss Re Life & Health America, and numerous other carriers (collectively, "Swiss Re America"). Swiss Re America employs nearly 2,200 people in 19 states and the District of Columbia.

[4] *General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals*, Department of the Treasury, April, 2013, p. 52. Online: http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf

receives claims payments (called "recoveries") from the reinsurer, those, too, will be included in income. If the reinsurance is transferred to a foreign reinsurer, the gross premium will generally be subject to the one per cent federal excise tax (FET) on reinsurance. The FET has been waived in tax treaties with countries that the Treasury Department finds have a significant corporate tax regime, including Germany and Switzerland.

Under the Administration proposal, a U.S. insurer that transfers reinsurance to a foreign affiliate would be denied a deduction for the premium. The ceding commission and any reinsurance recoveries would not be subject to tax, although the recoveries may not be paid until several years after the premium is paid for coverage of "long tail lines" such as medical malpractice or environmental liability. The Administration proposal includes a "domestic election" that would permit a foreign insurer to be taxed under U.S. tax rules on the reinsurance premium and related investment income, and to receive a foreign tax credit for foreign taxes paid on the reinsurance premium and investment income. Any foreign tax credits are assigned to a unique basket, rather than combined with other foreign tax credits available to the U.S. subsidiary, so that their utilization is limited.

AFFILIATE REINSURANCE IS PURCHASED FOR RISK MANAGEMENT PURPOSES, NOT TAX AVOIDANCE

Reinsurance is a key tool for management of risk by insurance companies. Domestic and foreign companies rely upon reinsurance to prevent insolvency and to some extent, to reduce the volatility of property/casualty insurance. For a rapidly growing company, reinsurance provides additional capacity that enables the company to accept new business. Affiliate reinsurance allows a parent company to pool similar business from different geographic areas and to purchase coverage for the entire group at a significantly lower price than subsidiaries in each country could obtain if they purchased coverage separately.

Large multi-national insurers seek to centralize capital in a single location, so that the foreign parent can manage investments efficiently, reduce the cost of capital, and respond promptly to claims from a subsidiary. This enables a foreign reinsurer to use its capital to cover windstorm damage in Europe one year, earthquake claims in South America another, and hurricane losses in the U.S. the next. This industry-wide practice allows companies to charge lower premiums than would be possible if capital were trapped in separate jurisdictions, and it clearly benefits consumers.

When assigning a rating to the U.S. subsidiary of a foreign company, rating agencies consider affiliate reinsurance as a favorable indicator of the importance of the U.S. subsidiary to the group. A high rating is important for primary insurers, and critical for reinsurers, since many companies instruct brokers to solicit bids only from reinsurers with a high rating. It would be anti-competitive to adopt a tax measure that penalizes a U.S. subsidiary of a foreign company for entering into affiliate reinsurance agreements necessary to preserve a high rating, while allowing U.S. headquartered insurers to take similar measures to preserve a rating.

Reinsurance is primarily undertaken to pool risk and reduce the risk of insolvency, rather than for tax avoidance reasons, as the Administration mistakenly charges. Allianz, Munich Re, and Swiss Re transfer risks from the U.S. to countries with substantial income tax regimes, which present no great opportunity for tax arbitrage. Germany and Switzerland are treaty partners that have satisfied the Treasury Department that they have significant corporate income tax regimes and have qualified for a waiver of the FET in their tax treaties. These countries are not the targets of OECD concerns about "base erosion" and should not be subjected to a penalty regime.

INTERNATIONAL REINSURANCE BENEFITS U.S. CONSUMERS

The U.S. insurance market, the world's largest, depends upon capacity provided by both foreign and domestic reinsurers to provide coverage. International reinsurance has allowed domestic companies to write coverage in high risk areas, subject to hurricanes and earthquakes, as well as to cover risks where losses can be severe (medical malpractice, product liability) or even catastrophic, such as the World Trade Center losses or coastal hurricanes. For example, Munich Reinsurance America covered \$1.32 billion of losses for the World Trade Center event in 2001, of which the German parent provided \$758 million (or 54%) as reinsurance coverage. Munich Reinsurance America also covered \$649 million for Hurricane Katrina losses, for which the German parent provided reinsurance coverage of \$574 million (or 88%). In the recent Hurricane Sandy losses, foreign reinsurers or their U.S. subsidiaries covered half of the insured losses, with Munich Reinsurance providing \$1.04 billion, Allianz providing \$590 million, and Swiss Re providing \$900 million.[5]

The Administration proposal would significantly impair the U.S. economy's recovery from major catastrophes. When catastrophes strike the U.S., foreign reinsurance has played an important role in alleviating the impact. Not only are U.S. consumers reimbursed for their losses, but a major portion of the overall economic loss is shifted outside the U.S., so that the American economy can recover more rapidly. If tax barriers to international reinsurance are created, catastrophic losses are more likely to remain within the U.S. economy, further slowing a recovery.

THE PROPOSAL PLACES U.S. SUBSIDIARIES OF FOREIGN INSURERS AT A COMPETITIVE DISADVANTAGE

Without question, the denial of the reinsurance premium deduction places a foreign owned insurer at a disadvantage vis-à-vis its U.S. competitors. Reinsurance is typically placed at year-end for the following year, so that premiums are paid in year one, but recoveries, in even

[5] Source: *Insurance Insider,* (January, 2013, updated 2/5/2013).

short tail lines, are not received until years two and three. In long tail lines, the delay between payment and recovery may stretch for several years. This results in a mismatch of income and expense inconsistent with insurance accounting, accelerates taxes, and is clearly disadvantageous to the foreign owned insurer.

The creation of a separate foreign tax credit basket --- not imposed on domestic insurers --- severely restricts the use of credits, and compounds the difference between a foreign owned company and a U.S. headquartered company. Finally, any tax rule that impedes a U.S. company's ability to maintain a high credit rating would also restrict its ability to compete for new business.

THE PROPOSAL WOULD VIOLATE THE U.S. TAX TREATY OBLIGATIONS

The proposal would violate the non-discrimination provisions of Art. 24 of the U.S. – German Tax Treaty (for simplicity, the German treaty is used as an example, but a similar provision is included in the Swiss Treaty, Art. 24). Art. 24, Par. 3 of the German Treaty provides,

> "disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for purposes of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State."

The Treasury Department Technical Explanation states simply, "Paragraph 3 prohibits discrimination in the allowance of deductions." The Technical Explanation recognizes that a deduction may be altered if a transfer pricing examination determines that the amount is excessive. No other limitations on deductions, other than transfer pricing, are recognized as exceptions to the non-discrimination requirement.

Significantly, Art. 24, Par. 4 expressly guarantees equal treatment for subsidiaries of a treaty partner corporation:

> "Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith that is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected."

The proposal would deny U.S. subsidiaries of foreign companies a deduction available to all U.S. insurers and, because of the mismatch of income and deductions, impose higher taxes on a U.S. subsidiary. The denial of such a major deduction is a clear violation of both the German and Swiss treaties' non-discrimination articles.

THE PROPOSAL WOULD VIOLATE WTO OBLIGATIONS

Under the General Agreement on Trade and Services (GATS), the U.S. committed to allow trade in reinsurance services. That commitment assures a foreign reinsurer that it will receive "national treatment," *i.e.,* each WTO member must treat foreign service suppliers in a manner that is "no less favorable" than it gives to like domestic services and service suppliers.

A tax comes within the scope of GATS if it "affects" trade in a service. The GATS provides that a national treatment violation exists if "like" foreign reinsurers and U.S. reinsurers are treated differently due to their respective national origin, and that differential treatment is less favorable to foreign reinsurers. In this case, the increased tax that would result from the mismatch of income and deduction for U.S. subsidiaries of foreign insurers, when compared to the immediate deduction granted domestic insurers, satisfies the requirement. Unfavorable treatment is further demonstrated by the restrictions imposed upon foreign tax credits, which do not apply to domestic insurers. In addition, the barrier to using affiliate reinsurance to support a subsidiary's credit rating is clearly detrimental to competition. The Administration proposal clearly deprives a foreign insurer's U.S. subsidiary of tax benefits available to domestic insurers and imposes higher taxes or higher costs upon the U.S. subsidiary.

SUMMARY

If the Administration proposal were enacted, it would result in higher taxes on U.S. insurance subsidiaries of foreign companies. Coverage would only be available to U.S. consumers at higher rates, and in some lines and certain high risk locations, might be severely limited or even unavailable. The Administration incorrectly labels a core business practice as tax evasion, a charge that has no basis when risks are transferred to foreign jurisdictions with significant corporate tax regimes.

The U.S. represents a large and significant market for Allianz of America, Munich Reinsurance America and Swiss Reinsurance America. For decades, these companies have provided a wide range of insurance and reinsurance coverage to U.S. businesses and individuals at affordable rates, and wish to continue to serve U.S. consumers without disruption or increased costs.

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